

# Alternative Structures for Life Sciences Companies: The LLC Holding Company

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# Outline

- Overview
- Establishing the LLC Holding Company
- Benefits and Drawbacks of Using the LLC Holding Company Structure
- Timing Considerations
- Summary



## Overview: What is Driving the LLC Structure?

- Life sciences companies often have – or envision – multiple programs
- Multiple programs offer possibilities
  - Multiple exits
  - Different funding streams for different programs
- Goal is to realize the maximum value for all programs



## The Drawback of the C-Corp

- Sale or license of a program results in double taxation if net proceeds are distributed to shareholders
- Sale of the stock of the whole company results in a single level of tax
  - Buyer gets all programs, not just the ones it really wants
  - Little or no value attributed to “other programs”
  - Buyer likely to shut down the unwanted programs
  - Seller and its shareholders cannot realize the value of the other programs



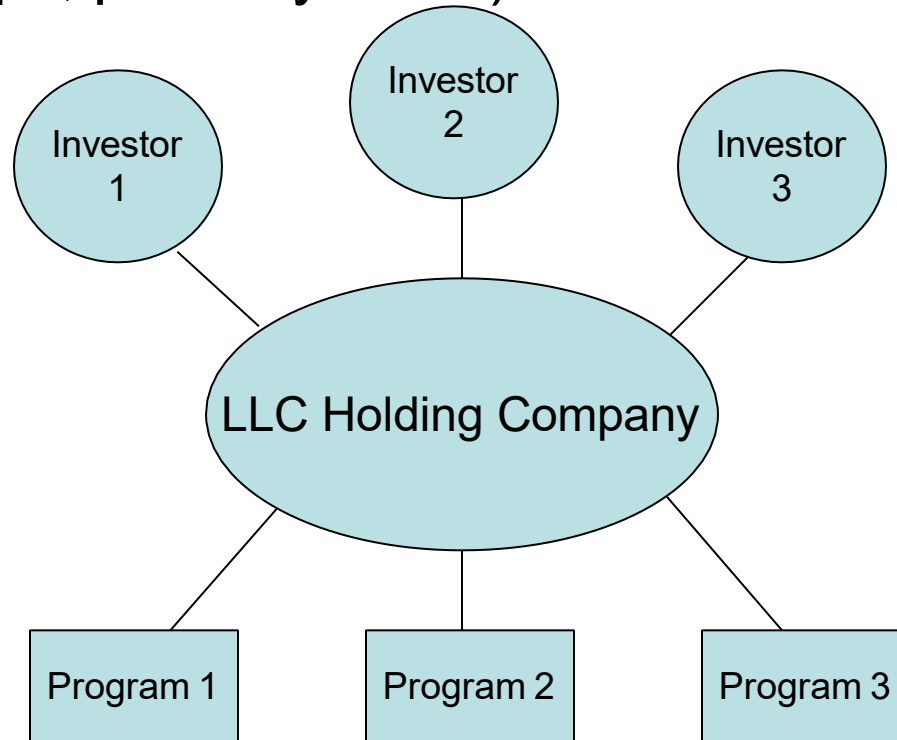
## What is the Alternative if Remaining a C-Corp?

- Spin-off the other program(s) at the time of the sale
  - Likely significant tax cost
- Spin-off the other program(s) at an early stage
  - Lower value results in limited, if any, tax cost
  - Independent companies
  - Required to finance each separately



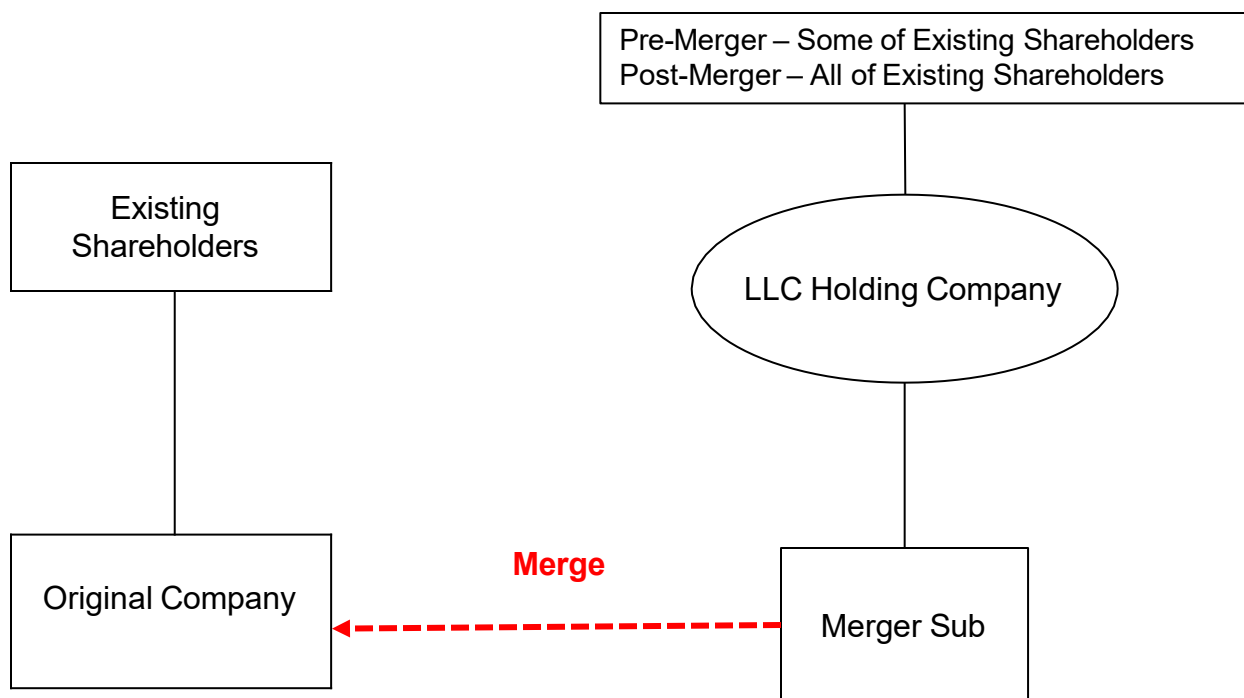
## The LLC Holding Company Structure

- Investors invest in LLC (taxed as a partnership) and programs are held in subsidiaries (typically C-corps; possibly LLCs)



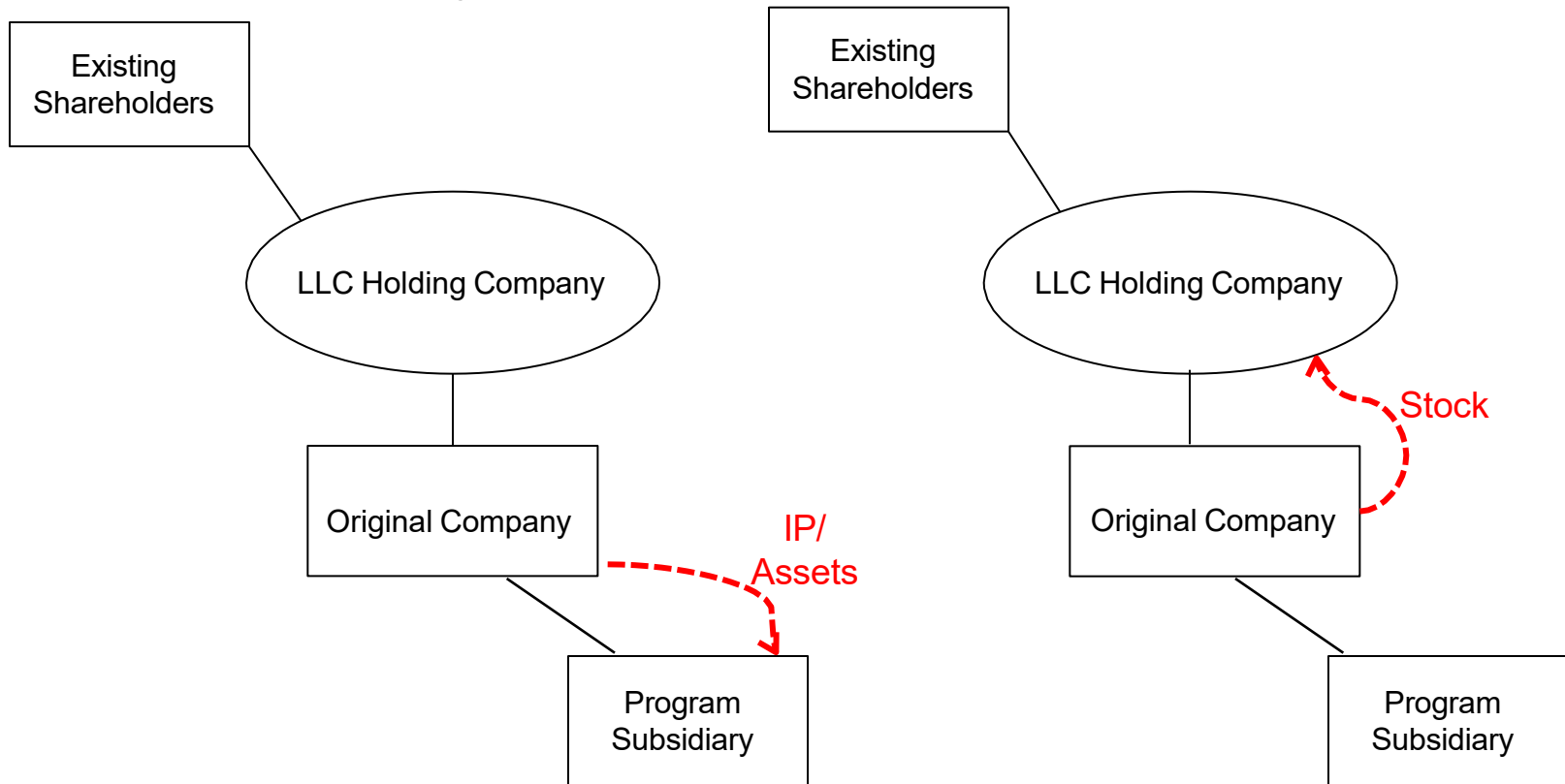
## Establishing the LLC Holding Co. Structure

Original Company Merges with Merger Sub (tax free). Some or all of the existing shareholders set up LLC Holding Company with a wholly-owned subsidiary corporation. The subsidiary then merges with and into Original Company with the shareholders of the Original Company receiving corresponding interests in LLC Holding Company. Merger is tax free.



# Establishing the LLC Holding Co. Structure

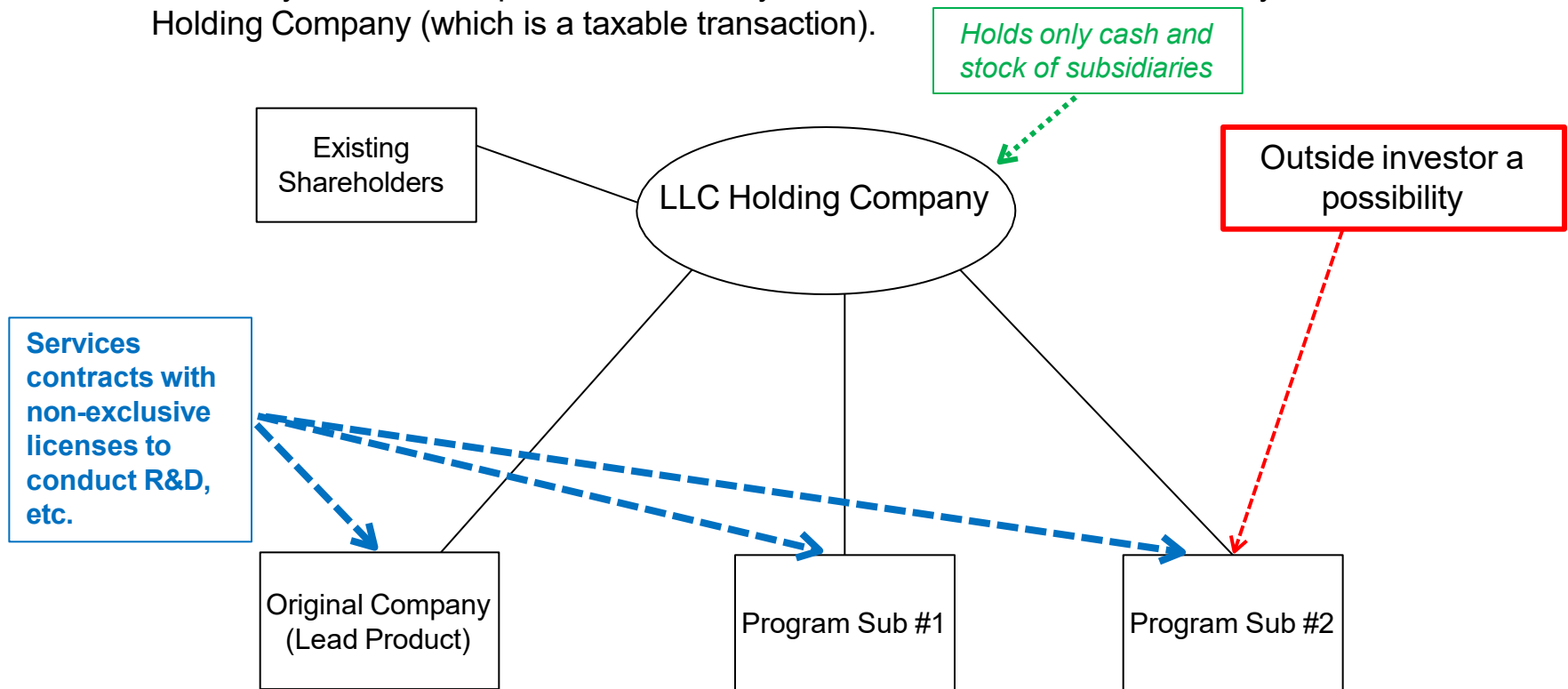
Creating the Program Subsidiaries. If a new program will be pursued out of IP located in the Original Company, the Original Company contributes IP to a newly formed C corporation subsidiary and distributes stock of subsidiary out to LLC Holding Company. Process is repeated for each program. This is a taxable transaction.





# Establishing the LLC Holding Co. Structure

Operating and Scaling Up. The R&D employees, administrative employees and lease remain at Original Company, which provides R&D services, administrative services and sub-leases space to each program subsidiary under intercompany services agreements. If a new program will be pursued out of IP located in an existing C corporation, that C corporation contributes IP to a newly formed C corporation subsidiary and distributes stock of subsidiary out to LLC Holding Company (which is a taxable transaction).



## Tax Benefits of LLC Holding Company Structure

- LLC holding company is a tax “pass through” vehicle
- If program sale and distribution of net proceeds is effected by sale of stock of subsidiary, just one level of tax
  - Taxable gain is passed through to investors in LLC
  - Distribution of cash proceeds to LLC investors is tax free
  - Possible use of the pass through entity taxes structure, allowing deduction of state taxes for direct and indirect individual investors/owner.
- Can provide management equity at LLC level through profits interest
  - No cash payment required – zero cost equity
  - Appreciation is capital gain rather than ordinary income
  - However, harder to explain to employees than options



## Other Benefits of LLC Holding Company Structure

- Facilitates “Pure Play” equity investment opportunities in individual programs (at program sub) as well as all programs (at LLC)
- Enhances preparedness for exit transactions, including management continuity after exits
- Provides convenient collection vehicle for contingent payments
- Can be implemented incrementally and is scalable



## Drawbacks of LLC Holding Company Structure

- More complicated capital structure
  - Employees and some investors are not familiar with LLCs
- Transfer of IP from Original Company into program subsidiaries is a taxable event from original company
  - Could result in current tax due by existing company and shareholders
- Expensive to establish and administer
  - Create and operate multiple entities instead of a single entity
  - Need to track and allocate management time and other costs



## Drawbacks of LLC Holding Company Structure

- Expensive to establish and administer, cont.
  - No consolidated tax returns
    - Undesirable if some subsidiaries generate income and others generate losses
  - Complex tracking of tax capital accounts
  - Corporate filings and sets of books and records for multiple entities
  - More expensive financing rounds because all economic and management terms must be precisely set forth; no corporate law to backstop
  - Need for Intercompany agreements



## Drawbacks of LLC Holding Company Structure

- Foreign investors and VC funds with institutional LPs may be reluctant to invest in LLCs
  - C corporation subsidiaries avoid UBTI and ECI issues
- Tax imposed on inter-subsidiary movement of cash
- License deals would be at subsidiary level
  - Double tax problem persists
- IP may need to be divided into fields in licenses to subsidiaries
  - May be tricky to draw lines between fields



## Timing Considerations

- Waiting until second program has matured means the tax cost to implement structure may be too high
- Establishing Holdco structure early in company life means a lower tax cost but may be offset by the extra cost of operating within the structure over time
  - Uncertainty as to likelihood of multiple exits



## Summary

- Is it worth it?
- Do you plan to develop multiple programs, monetize these programs creating multiple exit events and distribute the proceeds to the shareholders upon each exit event?





# Wilmer Cutler Pickering Hale and Dorr LLP

Bill Caporizzo

[william.caporizzo@wilmerhale.com](mailto:william.caporizzo@wilmerhale.com)

617-526-6411

Meghan Walsh

[meghan.walsh@wilmerhale.com](mailto:meghan.walsh@wilmerhale.com)

617-526-6132

Stuart M. Falber

[stuart.falber@wilmerhale.com](mailto:stuart.falber@wilmerhale.com)

617-526-6663